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THE BANK ROBBERY OF 2008

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The Paulson bailout failed in the House. It wasn't a death blow to the plan, but it should have been. This wasn't an economic plan: it was a heist.

It will go down as The Great Bank Robbery of 2008.

The economics behind it were nonsense, but we are naïve if we spend much time even considering the “arguments” for it. This was a money and power grab, pure and simple.

Just as magazine covers today feature scantily clad women that would have been scandalous a generation ago, in the same manner Paulson's proposal—made in broad daylight and on national TV!—was almost naked in its audacity.

Austrian economists tend to be libertarians in their political views, and they are often chided for not keeping these systems hermetically sealed and separated in their minds. Fortunately, this alleged vice is a virtue in our present situation. Because of all the mumbo jumbo thrown around to show why the plan is necessary, some very sharp academic economists are in a tizzy trying to treat this as an extra-credit question, rather than a crime scene. That is a waste of time.

The Keynesian justifications—coming from a “free-market” administration—are nonsense. But in the grand scheme, that's not entirely relevant. People didn't seriously consider the testimony of the tobacco company CEOs about the nonexistent dangers of smoking, because everyone knew those executives stood to lose billions from the settlement.

So by the same token, no one should pay much attention to the official statements made by Henry Paulson, since he stood to personally be put in charge of doling out hundreds of billions of dollars to some of the most powerful people on the planet.

In very simple terms, the Paulson Plan was a straight-up transfer of \$700 billion—and counting!—from the taxpayers to a few big financial institutions. (Some smaller banks are complaining that they don't own the exotic mortgage-backed derivatives, but rather simple mortgages. They do not believe they will see a dime of the Paulson money.) It's easy to get all twisted around, but just remind yourself of this: the Paulson Plan has the federal government borrow \$700 billion (through issuing Treasury debt) in order to buy assets from Wall Street banks. (We are neglecting the time delay in the program; the entire \$700 billion wouldn't be spent all at once.)

Some analysts think that the price paid for these “toxic” assets is important. No it isn't. The government officials running this operation will dole out the favors on both ➡



ends, when the mortgage-backed securities are coming and when they are going. Neglecting this insight, some people want to say that if the government pays \$700 billion for a portfolio of assets that is really only worth \$400 billion, then the taxpayers really only lost \$300 billion, not the full \$700 billion.

Yet this thinking is naïve. The taxpayers are not going to be treated as equivalent to shareholders of a firm that just acquired \$400 billion in assets. The taxpayers are not going to get a cut of the monthly mortgage payments (less the servicing costs on the \$700 billion in new debt) tied to the government's massive portfolio. Instead, the government will simply bump up its annual spending by a few billion dollars. Maybe it will have to spend the money on homeownership programs, or homebuilder job retraining, but the net income from those government-owned assets certainly won't translate into a dollar-for-dollar tax cut.

And then at some point, there will be a push to "privatize" the secondary mortgage market, and the government's portfolio at that time will be auctioned off at very generous prices to politically connected institutions. For example, maybe the \$400 billion portfolio is auctioned off for \$250 billion. (Perhaps the big banks have to set up subsidiaries owned by minorities and women who get preferential treatment in the bidding process. But whatever the ruse, they will find a way to justify the low prices.)

When all is said and done, the government will have played hot potato with the MBS, and the national debt—borne by taxpayers—would be \$450 (= \$700 - \$250) billion higher. The favored financial institutions would be "up" roughly

the same amount, collectively. (Through-out, we are ignoring the timings of the payoffs and the effect on present discounted value.)

It is the crudest Keynesianism to view the Paulson Plan as an injection of capital or "liquidity." That money has to come from somewhere. If it is taxed or borrowed, then it is just a shell game; the liquidity is drained from elsewhere, to be injected into Wall Street.

Besides taxing or borrowing, the government has a trump card: it can have the Federal Reserve simply create the new money out of thin air, by engaging in some "Open Market Operations." Yet even in this case, real wealth still hasn't increased. Certain nominal figures, like "aggregate asset values" might go up. But that's not very relevant, because the economy isn't *really* richer. After all, there aren't more tractors or office buildings just because Bernanke allows the monetary base to grow more rapidly.

So what happens in this case is that prices rise; people find it harder to buy milk, bread, and gasoline. But the Wall Street fat cats are fine with the general price hikes, because they got their hands on the newly injected funny money early in the game.

Some observers would admit the legitimacy of my analysis above. "However," they might say, "the Paulson Plan, or something like it, is necessary to avert a total meltdown of the financial system. We're not trying to boost aggregate investment, so much as clearing out a clogged pipe."

This talk of a breakdown in the financial system is a bogeyman. Steve Landsburg does such a great job of

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exploding this myth that I will simply quote him:

So what's special about banks [that they deserve a bailout]? According to what I keep reading, it's that without banks, nobody can borrow, and the economy grinds to a halt.

Well, let's think about that. Banks don't lend their own money; they lend other people's (their depositors' and their stockholders'). Just because the banks disappear doesn't mean the lenders will. Borrowers will still want to borrow and lenders will still want to lend. The only question is whether they'll be able to find each other.

..[A]s any user of match.com can tell you, the technology for finding partners has improved since [the 1930s]. When a firm wants to raise capital, why can't it just sell bonds over the web? Or issue new stock? Or approach one of the hedge funds that seem to be swimming in cash? Or borrow abroad?

..I'm not sure these big Wall Street banks are really necessary, and I'm not sure we'd miss them much if they were

gone. Maybe there's something I'm missing, but if so, I think it should be incumbent on Messrs. Bernanke, Paulson and above all Bush to explain what it is.

The Paulson Plan is a heist. It is a grand scheme in which the public will end up owing hundreds of billions of dollars to holders of new debt claims issued by the US Treasury. The plan won't "prop up" asset values and it won't provide any real stimulus to the economy.

Despite the dire warnings—coming from the same folks who brought you the Iraq invasion to remove WMD—there was no threat of a financial meltdown. If Goldman Sachs had failed, the sun would still rise the next morning.

Far from providing stability and confidence, the Fed, Treasury, and SEC's recent moves have ensured that US capital markets will now function with the same efficiency as public education in this country. The Paulson Plan is one more step in the socialization of America, but it is also a great bank robbery. ■

THE CAUSE OF THE CRISIS

Llewellyn H. Rockwell, Jr.

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What caused this? It is a simple question, and yet answers are all over the map, as you might expect. Here's mine in two words: *fiat money*.

The word "fiat" here means by order of the state, which is to say that it has no independent worth and is eventually worth nothing. The possibility of precisely that happening emerged in August 15, 1971. Since Nixon severed the last tie of the dollar to gold, the world's monetary system has not been restrained by anything physical. We've depended on the discretion of central bankers. We

can't trust that, and this crisis shows precisely why.

Of course there are subsidiary factors: the lifting of restrictions on Freddie and Fannie; subsidized lending; the Fed's artificially low interest rates; the Community Reinvestment Act; financial "deregulation"; the war; Bush profligacy; debt. There is much more besides. But fighting each of these forces individually is like battling down flies at the garbage dump. The core issue is that there is nothing to restrain money creation.

The first time that people hear this, they find their minds rather boggled, and

they want to know more. My whole experience in this area is that once people start digging around the area of monetary theory, they find that (1) it is not as difficult a subject as it seems, (2) it is endlessly fascinating, and (3) it explains far more than they realized before.

It was F.A. Hayek who bore this burden most directly for those in the English-speaking world. His books on the source of the business cycle and what to do about it appeared in the late 1920s and throughout the 1930s. These works were cited by the Nobel Prize Committee in 1974 as his most important contribution to economic thought. His ideas are directly applicable to our current plight.

It has been a real tragedy that these works have been out of print. But this year, the Mises Institute made a hard push to get this book out in time for the current financial calamity. We set other projects aside and worked all hours to bring out the definitive collection. It is *Prices and Production and Other Works: F.A. Hayek on Money, the Business Cycle and the Gold Standard*.

The book is priceless in its content and presentation. Specifically, Hayek explains the mechanism by which loose credit generates false signals to investors, leading them to chase fads all over the market, and ending in sector-wide failures. He was writing at a time when the gold standard provided partial restraint on the government and the central bank. No more. So Hayek's analysis of all of this is more penetrating than ever. The book also contains the complete text of his many battles with Keynes.

At the same time he was writing, his mentor Ludwig von Mises was battling it out in Austria and the German-speaking world. He became the great opponent of not only inflationary finance but also the Continent's version of the New Deal. The remarkable thing is that these essays were not translated until the 1980s and even then remained obscure. This book is really their first major debut, and it appeared only last year: *The Causes of the Economic Crisis*. You will see his

expository virtuosity at work and also his amazing courage and passion.

It has been a major task of the Austrian school since 1912 to explain to people what money is, how it works, and how its corruption and distortion by the state is the source of both inflation and business cycles. The core book here is Mises's own 1912 classic called *The Theory of Money and Credit*, written at the dawn of the central banking age. The prose is still crystal clear, and it continues to be the best textbook on money ever written.

In the American context of the Great Depression, one book captures the whole onset and response. It is Murray Rothbard's *America's Great Depression*. He shows that it wasn't the 1929 crash that was the problem; it was the response to the crash that created the Depression. Bailouts. Price controls. Wage controls. Government programs. Trade restrictions. Crackdowns on the capital markets. And who did all this? It originated not with FDR but with Herbert Hoover—clear echoes of today. There is no understanding the present crisis without this book.

Finally we need to realize the problem of loose money and its effects are not new and not necessarily twentieth century. The whole history of the American economy is littered with banking panics, bailouts, business cycles, and chaos, each with the same root. When the money goes bad, everything goes bad. Rothbard chronicles the long history of this in his marvelous book: *A History of Money and Banking in the United States*.

The Mises Institute has sponsored research on this topic since it was created in 1982. Our first conference was on the gold standard. We've suffered for this choice. The best way to fall out of favor with the regime is to question its central bankers. We've done that. But now, the work is done. It is available. The truth is out there. You only need to grab it, comprehend it, and spread it. ■

Surviving the Crisis

In the last several years, as an extension of a quarter of a century focus, the Mises Institute has worked very hard to make sure that the greatest books on the Austrian theory and policy of money and banking were all in print and available.

When the crisis hit, they were ready for worldwide distribution. The books are by Mises, Hayek, Rothbard, and others, including many books on the hyperinflations in Germany and France. In addition, we've worked to put into print the "old right" books of Garett Garrett, Albert Jay Nock, Frank Chodorov. These are people who fought back against FDR's New Deal, which was the government planning apparatus that prolonged and deepened the depression.

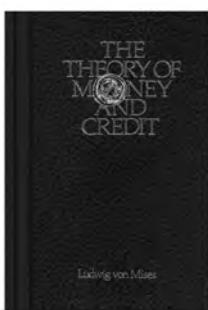
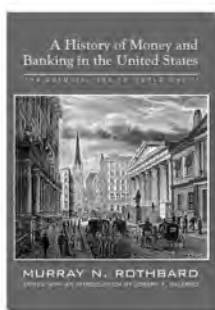
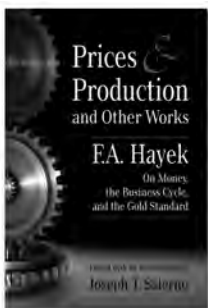
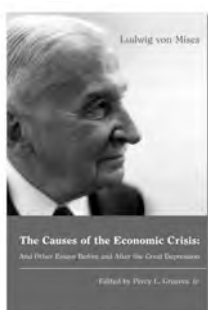
We have biography, theory, policy, history and much more—a complete library that is essential to intellectual battle. Unlike the past, the Austrian School today has the capacity to get the word out on the real cause of the business cycle and the real solution of sound money.

In addition, the Mises Institute is putting online a least a book a day to make out of print works available to the world for free download. Also, we've been conducting interviews with scholars and market watchers for analysis of the latest events.

It is also striking that there are many working economists today, in the financial markets and the universities, who have the intellectual capacity to understand and explain what is happening. Most of these individuals have benefitted from our educational programs over the years. This has been an investment we've made for the long run, and now that investment is paying off.

You have been a supporter of the Mises Institute precisely so that all these resources would be available in emergency times. Those times have arrived, and result is that the truth on the financial mess of our times can be heard. We are grateful to you for having confidence in this work, in the message of liberty, and in the capacity of ideas to make the critical difference.

These are good times to reflect on Mises's words from 1922: "No one can find a safe way out for himself if society is sweeping towards destruction. Therefore everyone, in his own interests, must thrust himself vigorously into the intellectual battle. None can stand aside with unconcern; the interests of everyone hang on the result." ■



Austrians on the Crisis

Ludwig von Mises (1931)



“The appearance of periodically recurring economic crises is the necessary consequence of repeatedly renewed attempts to reduce the ‘natural’ rates of interest on the market by means of banking policy. The crises will never disappear so long as men have not learned to avoid such pump-priming, because an artificially stimulated boom must inevitably lead to crisis and depression. . . . All attempts to emerge from

the crisis by new interventionist measures are completely misguided. There is only one way out of the crisis: Forgo every attempt to prevent the impact of market prices on production. Give up the pursuit of policies which seek to establish interest rates, wage rates and commodity prices different from those the market indicates.”

F.A. Hayek (1932)



“To combat the depression by a forced credit expansion is to attempt to cure the evil by the very means which brought it about; because we are suffering from a misdirection of production, we want to create further misdirection—a procedure that can only lead to a much more severe crisis as soon as the credit expansion comes to an end. . . . It is probably to this experiment, together with the attempts to

prevent liquidation once the crisis had come, that we owe the exceptional severity and duration of the depression. We must not forget that, for the last six or eight years, monetary policy all over the world has followed the advice of the stabilizers. It is high time that their influence, which has already done harm enough, should be overthrown.”

Murray Rothbard (1969)



“So now we see, at last, that the business cycle is brought about, not by any mysterious failings of the free market economy, but quite the opposite: By systematic intervention by government in the market process. Government intervention brings about bank expansion and inflation, and, when the inflation comes to an end, the subsequent depression-adjustment comes into play . . . what the government should do, accord-

ing to the Misesian analysis of the depression, is absolutely nothing. It should, from the point of view of economic health and ending the depression as quickly as possible, maintain a strict hands off, “laissez-faire” policy. Anything it does will delay and obstruct the adjustment process of the market; the less it does, the more rapidly will the market adjustment process do its work, and sound economic recovery ensue. The Misesian prescription is thus the exact opposite of the Keynesian: It is for the government to keep absolute hands off the economy and to confine itself to stopping its own inflation and to cutting its own budget.”

UPCOMING EVENTS

- THE MISES CIRCLE IN HOUSTON (Sponsored by Jeremy S. Davis)
January 24, 2009 • Houston, Texas
- AUSTRIAN SCHOLARS CONFERENCE
March 12–14, 2009 • Auburn, Alabama
- ROTHBARD GRADUATE SEMINAR
June 7–12, 2009 • Auburn, Alabama
- MISES UNIVERSITY
July 26–August 1, 2009 • Auburn, Alabama



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